HM Revenue
& Customs

Income Tax: Extension of averaging period for farmers

Consultation document

Publication date: 8th July 2015

Closing date for comments: 7th September 2015

Subject of this consultation:	This consultation discusses the extension of the averaging period for farmers' profits to 5 years.
Scope of this consultation:	The Government announced an extension of the averaging period for farmers to 5 years. This consultation explores ways in which the extension could be designed and implemented.
Who should read this:	Farmers, market gardeners, accountants, tax advisers and others with an interest in averaging of profits.
Duration:	8 July 2015 – 7 September 2015
Lead official:	Mark Bingham HMRC
How to respond or enquire about this consultation:	Mark Bingham HMRC Level 2 Dorchester House 52 -54 Great Victoria Street Belfast BT2 7WF Email: fa.consultation@hmrc.gsi.gov.uk
Additional ways to be involved:	HMRC and HMT will consider meeting interested parties to discuss the issues raised during this consultation. The timing, format and venue of these meetings will be informed by the expressions of interest received. Please send these to the above email address.
After the consultation:	The Government will take all responses into account and plan to publish draft legislation for comment in advance of introducing legislation in the 2016 Finance Bill.
Getting to this stage:	The Government announced an extension of the averaging period for farmers at Budget 2015.
Previous engagement:	Limited to informal exchanges with industry and representative bodies.

Contents

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Foreword

Our ambition is to see a thriving, resilient UK food and farming industry that leads the world in innovation. That's why we are working with the industry on an ambitious 25-year plan for food and farming. It is a vision which will help ensure skilled new entrants come into the industry; make it easier to set up and grow food and farming businesses; and build resilience while cutting red tape.

The world is not standing still – demand is growing, but new competitors are emerging and prices have been particularly volatile in recent years. Farmers across industry, from arable to dairy, know the challenges that this presents. We know this volatility is not a one-off. It is an inherent feature of agricultural markets, and we can expect more volatility in the future.

The challenge for the industry is to increase skill levels and productivity, improve the management of risk, and increase competitiveness. Part of the answer is the growth and increased use of important private industry market mechanisms for managing risk. But it is also important that the tax system better reflects the market realities that farmers face. That is why, as announced by the Chancellor in the March Budget, we are extending tax averaging for farmers.

As a result, from April 2016, farmers will be able to average out their profits from farming over five years instead of two years. This will help them better manage potential fluctuations in income caused by a range of industry specific factors. These vary from price movements in global markets to swings in yields caused by the weather or by disease.

The Government wants to have a tax system that is simple for taxpayers to understand and use. This consultation seeks the views of those who will be directly affected by the changes in this policy in order to help achieve this objective. The feedback will be important in ensuring the smooth implementation of the extension and that the policy is supportive of our objectives for the industry.

Elizabeth Truss MP
Secretary of State, Department for Environment, Food and Rural Affairs

David Gauke MP
Financial Secretary to Treasury

1. Introduction

1.1 At Budget 2015, the Government announced that it would extend the period for which self-employed farmers can average their profits for income tax purposes from 2 years to 5 years.

1.2 The Government wants the tax system to accommodate the realities faced by farmers, as it seeks to encourage a more efficient, productive, and resilient agricultural industry in the UK.

1.3 The extension will not apply to profits from creative works which will continue to be subject to the existing rules for averaging profits.

1.4 Farmers typically have volatile profits, due to factors such as the weather, disease outbreaks or fluctuating global product prices.

1.5 Averaging assists farmers by allowing them to spread profits over consecutive years to offset the effects of volatility on profits. Increasing the period over which farmers can average their profits from 2 years to 5 years will provide them with additional assistance in managing the volatility they face.

1.6 The aim of this consultation is to explore ways in which the extension to a 5 year averaging period could be designed and implemented. Following a review of the existing rules and processes and in keeping with high level objectives, two methods of delivering an extension to 5 years are presented in this consultation in Chapter 3.

High Level Objectives

- Extend averaging for farmers to 5 years
- Ensure that no profits fall out of charge
- Keep the rules as simple as possible to understand and operate

1.7 This consultation seeks views on the options presented for 5 year averaging. Chapter 3 details features of the existing rules that we expect to retain and possible ways of delivering the extension. We would appreciate answers to the specific questions raised but would also welcome comments on the options more generally.

2. Averaging profits of farmers

2.1 This chapter gives an overview of the existing rules for averaging profits of farmers and market gardeners in Chapter 16 of Part 2 of the Income Tax (Trading and Other Income) Act 2005.

2.2 Averaging works by using average profits for two years to calculate the tax due each year. It is generally only beneficial to claim if the marginal rates of tax or NIC are different over the two years.

Qualifying trades

2.3 Averaging can be applied to profits earned from farming[1] or market gardening in the UK, whether carried on alone or in partnership with somebody. It can also be used for the intensive rearing in the UK of livestock or fish on a commercial basis for the production of food for human consumption.

2.4 The relief only applies to unincorporated businesses, however, unincorporated businesses using the 'cash basis' are not permitted to claim averaging.

For the purposes of this consultation document the terms "farmer" or "farming" include all the aforementioned qualifying trades.

Qualifying conditions and operation

2.5 Claims for averaging are given effect in, or by amendment of, the self-assessment return of the later year. In other words averaging does not affect the amount of tax due for the earlier year. Averaging claims are made in the return of the later year by including an averaging claim tax adjustment in that return. This adjustment can be positive or negative depending on whether the later year's profits are higher or lower than the earlier year.

2.6 A claim for averaging must be made before the end of the first anniversary of 31 January following the end of the second tax year (so for example a claim for averaging for 2012-13 and 2013-14 must be made by 31 January 2016). Late claims may be permitted in limited circumstances, such as within the course of an enquiry.

2.7 The availability of averaging is subject to a "volatility" test. If the profits of one of the years are 70% or less of the profits of the other year, or the profits of one of the two years is nil, full averaging relief is available. If the profit of one of the years is more than 70% but less than 75% of the profit of the other year marginal relief is calculated based on a formula that is applied to increase the lower profit figure and reduce the higher figure by the equivalent amounts. If neither of the criteria are met then no averaging claim can be made.

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[1] For tax purposes "farming" is defined as being the occupation of land wholly or mainly for the purposes of husbandry (but does not include market gardening). "Market gardening" is defined as the occupation of land as a garden or nursery for the purposes of growing produce for sale.

2.8 For the purposes of averaging profits, the level of profits to be taken into account are:

i. after any adjustment for capital allowances and balancing adjustments

ii. after any adjustment under the legislation for compulsory slaughter of animals.

iii. before any reduction for losses

2.9 If profits for a pair of years have already been subject to an averaging claim then the averaged profits for the later year can still be considered for an averaging claim with the following year. For instance if 2014-15 profits had been averaged with 2013-14, the averaged profits for 2014-15 can be averaged with 2015-16 profits, assuming all other conditions are met. However, an averaging claim may not be made for a tax year if an averaging claim has already been made for a later tax year.

2.10 Averaging of profits cannot include a year in which the qualifying trade commenced or ceased. Similarly, a partner's profits cannot be averaged to include a year when they joined or left the partnership.

2.11 An individual making an averaging claim for any tax year may withdraw or amend claims to relief for that year under any other provision of the Income Tax Acts, or submit a new claim for such relief, at any time within the time limit for claiming averaging. This rule applies to 'any claim for relief for that year under any other provision of the Income Tax Acts', which includes a claim to loss relief. It does not apply to elections, for example for herd basis.

3. Extension of averaging period to five years and options for new framework

3.1 From tax year 2016-17 the period over which an individual who is carrying on a qualifying trade can average profits of the trade will be extended from the existing 2 years to a period of 5 years.

3.2 This will mean that where an averaging claim is made for a tax year from 2016-17 onwards the averaging period will be the year of claim and the previous 4 tax years rather than the year of claim and the previous year under the existing rules. So, for example, an averaging claim for tax year 2016-17 would result in the profits of tax years 2012-13 to 2016-17 being calculated by reference to averaging.

3.3 The averaging period will always be a period of 5 consecutive tax years ending with the year of claim unless there are fewer than 4 tax years eligible for averaging before the year of claim. Transitional rules will apply for newer businesses.

3.4 This section discusses issues that arise from implementing the change to averaging profits over a period of 5 years. As this change will require the existing rules to be revised we are taking the opportunity to consider what changes could also be made to simplify the way in which averaging will apply in order to reduce complexity in the operation of the relief.

Aspects of the existing relief which we expect to retain

3.5 The following aspects of the existing regime are effective and should be retained. This will underpin consistency and ease of transition.

- **a.** The definition of a qualifying trade will remain unchanged from the existing definition, with the exception that the extension will not apply to profits from creative works.
- **b.** Businesses using the cash basis will not be eligible for averaging relief.
- **c.** No averaging claims will be permitted in the years of commencement or cessation (including the year a partner joins or leaves a partnership).
- **d.** The averaging claim tax adjustment for earlier years will continue to be given effect in the self-assessment return of the latest year.
- **e.** If averaging claims are required, existing time limits will apply.
- **f.** Other claims to relief for a year to which an averaging claim relates may be revisited following an averaging claim.
- **g.** The “profits” for the purposes of averaging and meeting various qualifying conditions will continue to be calculated on the current basis, for example after capital allowances.

h. For the purposes of averaging, losses will be treated as nil profit.

Question 1
Are there any other aspects of the current rules that should be retained?

Impact on profits

3.6 The purpose and effect of averaging is to smooth the level of profits. Whether farmers have made previous averaging claims or not, an averaging claim should have no impact on the overall level of profits chargeable over the period affected. The mechanism employed to achieve this is that the profits to be averaged in earlier years are the previously charged final profits, whether averaged or not. This is illustrated in the example below:

Example A: Previous averaging claims made: 2016-17 adopts 5 year averaging

Year	2012-13	2013-14	2014-15	2015-16	2016-17	Total
Profit	20,000	50,000	20,000	50,000	60,000	200,000
Averaged (current rules)* to 2015-16	35,000*	27,500*	38,750*	38,750*	60,000	200,000
Averaged 2016-17	40,000	40,000	40,000	40,000	40,000	200,000

* Interim average figures are based on the original two year average claims: for example the 2012-13 average £35,000 is based on the average of original profits in that year £20,000 and the following year £50,000. The £35,000 average is then also used for 2013-14 in order to average with the original profits of 2014-15 £20,000 to give an interim average of £27,500.

Options for the new framework from 2016-17

3.7 The change to an extended averaging period of 5 years from tax year 2016-17 provides an opportunity to reconsider some of the fundamental design aspects within the existing regime with a view to providing simplification. Factors to consider are:

a. Should a “volatility” test be retained?

b. Should averaging relief be automatic or optional?

c. What transitional rules would be required?

3.8 We believe that it would be possible to design a framework that simplifies but builds on the existing averaging regime or to design a simpler framework overall that would reduce the need for claims to be made. These options are discussed in the following paragraphs.

Option A Building on the current framework

3.9 This option would be based on the current rules with modifications to deliver the extension to a 5 year averaging period and some simplification.

3.10 The essential features would be as follows:

i. Annual claims for averaging relief would still be required

ii. Retain annual volatility test by reference to a 70% test between current year and the average of the previous 4 years

iii. No marginal relief.

iv. Transitional averaging for newer businesses

Volatility test and Claims

3.11 We would propose that the current system of claims would be retained, requiring sole traders or partners to claim averaging within their self-assessment return.

3.12 Averaging is intended to smooth out material volatility in farming profits. In order to prevent claims that might otherwise be made in relation to modest levels of volatility, with minimal tax impact and to ensure that administrative burdens are proportionate, we consider that an annual claim based approach will require a volatility test as a qualifying condition.

3.13 There are various potential methods of making comparisons of profit volatility across a 5 year period, for example, one method might be to retain the test between the current and immediately preceding year. However that method would only take account of volatility over a 2 year period. A current and preceding year's volatility comparison also has the disadvantage of being dependent, in part, on whether the preceding year profit was a previously averaged figure.

3.14 As the averaging claim from 2016-17 would have the effect of averaging 5 years profits, it seems appropriate that the measure of volatility should also be based on all 5 years. Our proposed methodology therefore is to compare the profits of the current year with the average of the profits of the previous 4 years. Where one of the two figures is 70% or less of the other, then the volatility test will have been met. This is illustrated as follows:

Example B: No previous averaging claim made: sufficient volatility arises to allow an averaging claim in 2016-17.

The average profits for the 4 previous years is calculated as £35,000. This comparator figure is 58% of the profits of the 2016-17 year of claim (£60,000). As 58% does not exceed 70% the volatility test has been met.

Year	2012-13	2013-14	2014-15	2015-16	2016-17	Total
Profit	20,000	50,000	20,000	50,000	60,000	200,000
Average of 2015-16 to 2012-13 comparator				35,000		
Average	40,000	40,000	40,000	40,000	40,000	200,000

Example C: Previous averaging claims were made: an averaging claim in 2016/17 is again possible because the average profits comparator for the 4 previous years (£35,000) does not exceed 70%. The volatility test has again been met; as in the previous example 58% does not exceed 70%.

Year	2012-13	2013-14	2014-15	2015-16	2016-17	Total
Profit	20,000	50,000	20,000	50,000	60,000	200,000
Averaged (old regime) to 2015-16	35,000	27,500	38,750	38,750		
Average of 2015-16 to 2012-13 comparator				35,000		
Averaged 2016-17	40,000	40,000	40,000	40,000	40,000	200,000

3.15 In addition, we recognise that volatility may manifest itself through the presence of trading losses. We therefore propose to further define the volatility test as having been met if any of the relevant 5 years are treated as nil profits for the purposes of averaging (i.e. a loss arises in any of those years). The following example illustrates the approach:

Example D: Volatility test met because of losses being present during the averaging period.

Year	2012-13	2013-14	2014-15	2015-16	2016-17	Total
Profit	30,000	(10,000)	40,000	50,000	40,000	160,000
Average of CY 2015-16 to 2012-13 comparator.				30,000		
Average	32,000	32,000	32,000	32,000	32,000	160,000

The comparator of £30,000 is not less than 70% of the 2016-17 profit of £40,000 so in applying that measure, the volatility test would not be met. However averaging would still be permitted because at least one of the 5 relevant years would be treated as nil profit for the purposes of averaging (i.e. the loss arising in 2013-14). The volatility test is considered to be met in such circumstances.

Question 2
Do you agree the proposed methodology for applying the volatility test under Option A, if not please explain your reasoning?

Marginal relief

3.16 Marginal relief currently applies by adjusting the profits of the two years by an equivalent amount, using a formulaic approach. Adapting marginal relief, as currently exists, to adjust profits over an extended 5 year period would introduce a significant layer of complexity to averaging. We consider that this complexity would be disproportionate to the benefit of retaining marginal relief and therefore propose to dispense with marginal relief.

Question 3
Do you agree that a marginal relief should be omitted from the new rules?

Transitional averaging

3.17 Newer farmers would be able to make averaging elections when there are two years of qualifying profits to average (excluding the year of commencement). Although there is no requirement that claims would have to be made in consecutive years, any claim made would be required to cover as many earlier years as possible. For example, a farmer commencing in 2016-17 could make their first averaging claim in 2018-19 to average 2017-18 and 2018-19. The volatility test would be based on a comparison between profits of those two years. A subsequent claim for tax year 2019-20 would cover the years 2017-18 to 2019-20.

3.18 The example below shows how the transitional arrangements might impact in the early years of the trade:

Example E: Farmer commences in 2016-17: averaging cannot apply in the year of commencement, so the first eligible claim would be for 2018-19 to average 2017-18 & 2018-19. The second claim would cover the 3 years 2017-18 to 2019-20.

Year	2016-17	2017-18	2018-19	2019-20	2020-21	Total
Profit	20,000	30,000	50,000	70,000	30,000	200,000
Claim 1 Average	20,000	40,000	40,000			
Claim 2 Average	20,000	50,000	50,000	50,000		
Claim 3 Average	20,000	45,000	45,000	45,000	45,000	200,000

Question 4
Would Option A (including transitional arrangements) achieve the aim of delivering the 5 year extension to averaging while reducing complexity in the way that the relief works?

Option B Developing a new framework

3.19 This option would significantly reduce the qualifying conditions and provide automatic averaging for a fixed period.

3.20 The essential features are as follows:

i. No requirement for a volatility test

ii. No requirement for an annual claim

iii. Irrevocable opt in election for 5 years

iv. Transitional averaging for newer businesses

3.21 When considering volatility of profits over a longer period such as 5 years, one might consider that the essential policy intent is simply to smooth volatility in profits over 5 years, irrespective of the degree of volatility. This provides an opportunity to consider moving away from an annual claim based regime requiring a volatility test, to mandatory or automatic averaging of profits for qualifying trades. This would bring a significant degree of simplification and a reduction in the administrative burden. Initially we considered if the best approach could be to provide mandatory averaging relief for qualifying trades (other than for commencement or cessation years).

3.22 On many levels this remains appealing as the circumstances whereby averaging will be disadvantageous are unusual. When annual tax rates and rate bands are static, ongoing averaging claims will either be tax neutral or advantageous to the claimant. Modest changes in rates are similarly unlikely to materially disadvantage a taxpayer when a number of consecutive years are averaged. Over a 5 year period however, it is possible that changes in rates or bands may have greater impact and therefore averaging may on occasion lead to increased tax liability (in particular if the trade ceases so that future averaging claims were not possible).

3.23 Of course many factors are at play here, but our conclusion is that while averaging over a number of years will almost always be advantageous, there may be exceptions.

3.24 With that in mind we consider that it would be appropriate to allow some flexibility rather than having a mandatory regime. Nonetheless, we think there is merit in an approach which provides continuity and stability through a degree of permanence. This option therefore proposes that an individual carrying on a qualifying trade would elect to opt-in to averaging for a fixed period of 5 years.

3.25 Under this option the individual, either as a sole trader or partner, would make an election for averaging. The effect of that election would be an ‘opt-in’ to averaging for that tax year and the next 4 tax years, resulting in 5 year averaging relief for that year and the next 4 tax years without the need for a further election. At the end of the five-year period the individual would, if desired, be able to elect again to opt-in to averaging over the subsequent five year period.

3.26 For example, if an 'opt in' election was made in relation to tax year 2016-17 then 5 year averaging would apply to the claimant's profits for each of the tax years 2016-17 to 2020-21 by reference to the 4 previous year's profits. Profits would not be averaged in 2021-22 unless a new 'opt in' election was made. If the trade ceased during that 5 year period, no averaging would apply in the final period of the trade. The example below illustrates the approach:

Example F: No previous averaging was possible prior to 2016-17 as the existing volatility test was not met prior to that, a 5 year opt-in election claim was however made in 2016-17.

This table illustrates how the initial 5 year averaging in 2016-17 impacts to smooth the profits out for the 5 year period 2012-13 to 2016-17 and the effect of automatic averaging for 2017-18.

Table 1

Year	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Original Profit	40,000	50,000	60,000	50,000	70,000	59,000
2016-17 Averaged revised profits	54,000	54,000	54,000	54,000	54,000	
2017-18 Averaged revised profits		55,000	55,000	55,000	55,000	55,000

Note that the 2012-13 revised profit of £54,000 cannot itself be subsequently averaged again in 2017-18, as it is not within the previous 4 years, it is therefore a final figure of profit. In contrast the averaged profit of £54,000 for 2013-14 will form part of the total profits for the purposes of the automatic 2017-18 averaging calculation. The 2017-18 average of £55,000 is arrived at by taking the average of £59,000, £54,000, £54,000, £54,000 and £54,000.

The effect of continued automatic averaging for a further 3 years until 2020-21 is demonstrated in the next table:

Table 2

Year	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Original Profit	60,000	50,000	70,000	59,000	30,000	100,000	90,000
2018-19 Averaged revised profits	50,000	50,000	50,000	50,000	50,000		
2019-20 Averaged revised profits		60,000	60,000	60,000	60,000	60,000	
2020-21 Averaged revised profits			66,000	66,000	66,000	66,000	66,000

The final table below provides a comparative summary (as at 2020-21) of the original profits and the revised profits post averaging. It demonstrates the impact of the automatic application of averaging 5 years profits for 5 consecutive years.

The profits have been significantly smoothed out over the period, nonetheless the total profits charged remain unaltered at £549,000.

Table 3

Year	12-13	13-14	14-15	15-16	16-17	17-18	18-19	19-20	20-21	TOTAL
Original Profit	40,000	50,000	60,000	50,000	70,000	59,000	30,000	100,000	90,000	549,000
Revised average profits	54,000	55,000	50,000	60,000	66,000	66,000	66,000	66,000	66,000	549,000

Transitional averaging

3.27 Newer businesses would be able to elect to opt-in when there are 2 years of qualifying profits to average (excluding the year of commencement). Averaging would then occur on a rolling basis in each of the subsequent 4 tax years, covering all previous years except for the commencement year. For individuals who elect to opt in, this approach would give effect to averaging relief at the earliest opportunity.

3.28 There would also be considerable flexibility in that although an individual starting business in 2016-17 could elect to opt in from 2018-19 they could instead choose to wait until 2021-22 but still avail themselves of averaging between 2017-18 and 2021-22.

Question 5
Would Option B (including transitional arrangements) achieve the aim of delivering the 5 year extension to averaging while reducing complexity in the way that the relief works?

Question 6
We would welcome your views on the two alternative frameworks. What are (a) the advantages and disadvantages of Option A, and what are (b) the advantages and disadvantages of Option B?

Question 7
Do you consider that there are circumstances in which the options would give rise to outcomes inconsistent with the policy objectives outlined in paragraph 1.6 and, if so, in what circumstances and how might these situations be addressed?

4. Assessment of Impacts

Summary of Impacts

Exchequer impact (£m)	2015-16	2016-17	2017-18	2018-19	2019-20
	-0	-10	-30	-30	-30
Economic impact	The extension of averaging period for farmers is not expected to have any significant macroeconomic impact. Eligible individuals choosing not to average their profits under the current system may alter their behaviour, electing to average profits over five years if there is an observed tax benefit.				
Impact on individuals and households	The number of self-employed farmers affected by the measure will depend on the final design. However, it is expected that the majority of individuals affected will benefit from a monetary gain as a result of the extension to the averaging period.				
Equalities impacts	We do not think this will have a detrimental impact on individuals with particular protected characteristics.				
Impact on businesses and Civil Society Organisations	Dependent on final design. The changes may reduce future administration and compliance costs, for example if proceeding with Option B where an opt-in to averaging would remove the need for annual claim.				
Impact on HMRC or other public sector delivery organisations	Dependent on final design the changes may reduce future administration costs. Implementation costs are expected to be negligible.				
Other impacts	Other impacts have been considered and none have been identified.				

5. Summary of Consultation Questions

Question 1
Are there any other aspects of the current rules that should be retained?

Question 2
Do you agree the proposed methodology for applying the volatility test under Option A, if not please explain your reasoning?

Question 3
Do you agree that a marginal relief should be omitted from the new rules?

Question 4
Would Option A (including transitional arrangements) achieve the aim of delivering the 5 year extension to averaging while reducing complexity in the way that the relief works?

Question 5
Would Option B (including transitional arrangements) achieve the aim of delivering the 5 year extension to averaging while reducing complexity in the way that the relief works?

Question 6
We would welcome your views on the two alternative frameworks. What are (a) the advantages and disadvantages of Option A, and what are (b) the advantages and disadvantages of Option B?

Question 7
Do you consider that there are circumstances in which the options would give rise to outcomes inconsistent with the policy objectives outlined in paragraph 1.6 and, if so, in what circumstances and how might these situations be addressed?

6. The Consultation Process: How to Respond

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the detailed policy design and a framework for implementation of a specific proposal, rather than to seek views on alternative proposals.

How to respond

Responses should be sent by 7th September 2015, by e-mail to fa.consultation@hmrc.gsi.gov.uk or by post to:

Mark Bingham
HMRC
Level 2
Dorchester House
52-54 Great Victoria Street
Belfast
BT2 7WF

Or by fax to 03000 524889

Telephone enquiries 03000 511496 (from a text phone prefix this number with 18001)

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from HMRC's GOV.UK pages . All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentially can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the Government's Consultation Principles.

The Consultation Principles are available on the Cabinet Office website: http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

If you have any comments or complaints about the consultation process please contact:

Oliver Toop, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

Annex A: Existing Legislation

Income Tax (Trading and Other Income) Act 2005

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.

[(6) For the purposes of this Chapter references to the relevant profits of a tax year are to profits after any adjustment made under Chapter 16ZA (compensation for compulsory slaughter of animals).]

[221A Claim not available where cash basis used]

[Nothing in this Chapter applies in calculating the profits of a trade on the cash basis.]

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.