

Written evidence submitted by the Association of Taxation Technicians (ATT)

Finance Bill 2017-19: Clause 17 and Schedule 3 (Trading Allowance)

Overview

1. Clause 17 and Schedule 3 of the Bill contain the provisions for introducing the trading and property allowances with effect from 6 April 2017. Our focus is on the trading allowance.
2. As drafted, the provisions discriminate against individuals who in addition to having the type of micro-business to which the trading allowance is intended to apply also have a sole-trader business which cannot benefit from the trading allowance. In that situation, the provisions prevent the micro-business from qualifying for the trading allowance.
3. In this evidence, we:
 - summarise how the trading allowance works,
 - explain how the discrimination arises,
 - suggest some amended wording which would overcome the apparent anomaly at the same time as preventing the type of abuse which the current wording is designed to counter, and
 - provide an example of how such an amendment would operate.

Basic working of the trading allowance

4. The provisions require the calculation of an individual's *relevant income* for a tax year. In the context of trading income, this is defined by s.783AC(1)(a) as 'the receipts for the tax year of the individual's *relevant trades* for the tax year'. S.783AC(2) explains that receipts in this context means gross income.
5. A trade, profession or vocation carried on by an individual is identified by s.783AA as a relevant trade unless it is either carried on in partnership or constitutes a rent-a-room trade.
6. Where an individual's relevant income does not exceed their trading allowance for the tax year (£1,000 for tax year 2017/18), they automatically qualify for full relief and (unless they elect otherwise) the actual income and expenditure of their relevant trades is treated as nil. In that situation, the individual has no obligation to notify HMRC of the existence of or income from any relevant trade.
7. Where an individual's relevant income *does* exceed their trading allowance for the tax year, there is no automatic entitlement to the trading allowance but they can elect for partial relief. If they do so and they have a single relevant trade, the taxable profits of that trade are calculated by deducting from the gross income the amount of their trading allowance (£1,000 for 2017/18) in place of their otherwise deductible expenses. If they have more than one relevant trade, special rules permit the allocation of the single £1,000 trading allowance across the relevant trades (again in place of what would otherwise be the deductible expenses of each of the relevant trades).

Where an individual has elected for partial relief, they are obliged to notify HMRC of the existence and taxable income of each relevant trade.

How the discrimination arises

8. Where an individual has both a micro-business (with gross income of less than the trading allowance) and an ordinary sole-trader self-employment business ('sole-tradership'), they will not qualify for full relief (section 6 above) as their relevant income is the aggregate of the receipts of both the micro-business and the sole-tradership.
9. In the same circumstances as in section 8 above, election for the partial relief provisions (see section 7 above) to apply would be extremely unlikely to provide any benefit to the individual as they would only be able to deduct the amount of a single trading allowance from the combined gross income of both the micro-business and the sole-tradership. That would only be beneficial if the combined actual expenses of the two businesses was less than the amount of the trading allowance.
10. We understand from HMRC that the definitions of 'relevant trade' and 'relevant income' are designed to ensure that a sole-trader with a single business does not seek to abuse the trading allowance provisions by fragmenting off up to (currently) £1,000 of that business's gross income and claiming that it arises in a separate sole-trader business.
11. We recognise the importance both of preventing such possible abuse and of keeping these provisions as simple as possible. However, the particular approach adopted is inconsistent with the stated policy objective 'to provide simplicity and certainty regarding income tax obligations on small amounts of income from providing goods, services, property or other assets' (*HM Treasury Explanatory Notes*, paragraph 53 on page 61). It also operates in a discriminatory manner as illustrated in section 12 below.
12. We have noted in sections 8 and 9 above that an individual with both a sole-tradership and a micro-business is unable to benefit from the trading allowance in either its full relief or partial relief forms. By contrast, an individual with an identical micro-business but whose main source of earned income was either an employment or income from a partnership would be entitled to the full or partial relief as appropriate on their micro-business income because their relevant income for the purposes of the trading allowance would be restricted to that from the micro-business itself¹. This would be the case regardless of the amount of income which such an employee or partner derived from their main source of income.
13. We are of the opinion that the definition of relevant trades can be refined in a manner which:
 - achieves the revenue-protection objective of preventing abuse of the trading allowance,
 - requires no overly-complex anti-avoidance provisions, and
 - eliminates the current discrimination against sole-traders.
14. We set out in section 15 below the type of amendment to s.783AA(1) which we think would deliver the above outcomes.

¹ Employment income is not trading income. Income from a trade carried on in partnership is specifically excluded from being a relevant trade – see section 5 above.

Suggested amendment to section 783AA(1)

15. The emboldened italicised text below signifies our suggested amendments to s.783AA(1):

“783AA “Relevant trade” of an individual

(1) For the purposes of this Chapter, a trade carried on by an individual is a “relevant trade” of the individual for a tax year if—

- (a) the individual carries on the trade otherwise than in partnership, ~~and~~
- (b) the trade is not a rent-a-room trade in relation to the individual for the tax year,
- (c) ***the expenses otherwise deductible in the calculation of the taxable profits of the trade are less than the amount of the individual’s trading allowance for the tax year, and***
- (d) ***the trade is wholly distinct from and unrelated to any trade carried on by the individual which does not meet the condition in subsection (1)(c).”***

16. The suggested additional condition in s.783AA(1)(c) above (through section 783AC(1)(a)) excludes from the calculation of an individual’s “relevant income” the receipts from any trade that could not in any case benefit from the trading allowance (because the level of deductible expenditure in the particular trade exceeded the maximum available trading allowance).

17. The suggested additional condition in s.783AA(1)(d) is inserted to address HMRC’s concern about possible abuse of the trading allowance through the fragmentation of what is in reality a single trade. By requiring a qualifying micro-business trade to be “wholly distinct from and unrelated to” the individual’s non-qualifying sole-tradership, the wording makes it plain through the use of ordinary English how divorced the qualifying and non-qualifying trades have to be in order for the trading allowance to be available on the income from the micro-business.

Example of how the suggested amendment would work

18. Jane has been working part-time for a number of years as a self-employed chiropodist. Her gross annual receipts are £25,000 and her tax-deductible expenses are £6,000 so her net income from her chiropody practice is £19,000.

19. In April 2017, Jane starts to give occasional juggling lessons. Her gross annual receipts from that source are £900 and her annual expenses are only £100 so her net income from juggling lessons is £800.

20. In February 2018, Jane receives £300 for speaking at a conference on the changing chiropody needs of the elderly. Her unreimbursed travel expenses to the conference were £120 so her net income from speaking is £180.

21. In order to determine her entitlement to the trading allowance for the tax year 2017/2018 *under the Bill provisions*, Jane must first calculate her relevant income by aggregating her gross receipts from her chiropody, juggling and speaking activities. This gives £26,200 (being £25,000 + £900 + £300). As that figure exceeds £1,000, Jane is not entitled to full relief (sections 783AE and AF). Electing for partial relief (section 783AH, AI and AK) would be pointless as that would mean that Jane could only deduct £1,000 from her aggregate gross

income of £26,200 instead of her actual deductible expenses of £6,220 (being £6,000 + £100 + £120). Jane would therefore have to declare the full amount of her combined chiropody, juggling and speaking profits of £19,980 (being £19,000 + £800 + £180) for tax purposes.

22. Under our suggested: amendment

- Jane's chiropody practice is not a relevant trade as her otherwise deductible expenses of £6,000 do not meet the test in s.783AA(1)(c). The receipts from the practice do not therefore form part of her relevant income for the year. That means that the trading allowance is not available against that source and that Jane must declare the full net profit of £19,000 as her taxable income from that source.
- Jane's juggling activities meet all the conditions in s.783AA(1) so they constitute a relevant trade and the gross receipts for the year of £900 need to be included in the calculation of Jane's relevant income for the purposes of the trading allowance.
- Jane's expenses of £120 incurred in connection with her speaking activities meet the condition in s.783AA(1)(c). However, her speaking activities are not 'wholly distinct from and unrelated to' her chiropody practice trade and the practice expenses did not meet the s.783AA(1)(c) condition. The speaking activities are not therefore a relevant trade and the speaking receipts are not part of Jane's relevant income for the year. That means that the trading allowance is not available against Jane's speaking income. Jane must therefore declare the full net profit of £180 as her taxable income from that source.
- As Jane's only relevant income for the year is the £900 from her juggling lessons and as that does not exceed the available trading allowance of £1,000, she is entitled to full relief on the particular source. Her profits (or losses) from juggling lessons are treated as nil and there is no obligation on Jane to notify HMRC of the existence of the activity or of its income for the year.

23. By excluding the income from both Jane's main sole-trading business (her chiropody practice) and the related activity (the speaking) in the calculation of her relevant income for the purposes of the trading allowance, Jane is not given any advantage. She is simply put in the same position as someone who has a micro-business activity (juggling lessons in our example) and who earns their main income (chiropody in our example) as either an employee or a partner. In each case, only the micro-business qualifies for the trading allowance.

24. Our suggested s.783AA(1)(d) ensures in our example that Jane's speaking activity which is related to her chiropody practice activities cannot be fragmented away from the practice in order to qualify for the trading allowance.

25. We believe that our suggested amendments to s.783AA(1) overcome the discrimination against sole-traders identified in this note without opening opportunities for abuse of the trading allowance or requiring complex anti-avoidance provisions.

Appendix: The Association of Taxation Technicians

The Association is a charity and the leading professional body for those providing UK tax compliance services. Our primary charitable objective is to promote education and the study of tax administration and practice. One of our key aims is to provide an appropriate qualification for individuals who undertake tax compliance work. Drawing on our members' practical

experience and knowledge, we contribute to consultations on the development of the UK tax system and seek to ensure that, for the general public, it is workable and as fair as possible.

Our members are qualified by examination and practical experience. They commit to the highest standards of professional conduct and ensure that their tax knowledge is constantly kept up to date. Members may be found in private practice, commerce and industry, government and academia.

The Association has over 8,300 members and Fellows together with over 5,000 students. Members and Fellows use the practising title of 'Taxation Technician' or 'Taxation Technician (Fellow)' and the designatory letters 'ATT' and 'ATT (Fellow)' respectively.

Association of Taxation Technicians

6 October 2017