

SCHEDULES

SCHEDULE 22

Section 64

COMPUTATION OF PROFITS: ADJUSTMENT ON CHANGE OF BASIS

PART 1

INTRODUCTION

General scheme

- 1 (1) Where there is a change of basis within section 64, one or more adjustments shall be made in accordance with this Schedule.
- (2) Any such adjustment shall be calculated and given effect in accordance with the provisions of Part 2 of this Schedule (general rules), subject to the provisions of Part 3 of this Schedule (special rules for certain cases).
- (3) Part 4 of this Schedule contains supplementary provisions and Part 5 provides for commencement.

PART 2

GENERAL RULES

Calculation of adjustment

- 2 The amount of the adjustment is calculated as follows:

First step

Add together any amounts representing the extent to which, comparing the two bases, profits were understated (or losses overstated) on the old basis:

1. Receipts which on the new basis would have been brought into account in computing the profits of a period of account before the change of basis, to the extent that they were not so brought into account.
2. Expenses which on the new basis fall to be brought into account in computing the profits of a period of account after the change, to the extent that they were brought into account in computing the profits of a period of account before the change of basis.
3. Deductions in respect of opening trading stock or opening work in progress in the first period of account on the new basis, to the extent that they—
 - (a) are not matched by credits in respect of closing trading stock or closing work in progress in the last period of account before the change, or

Status: This is the original version (as it was originally enacted).

- (b) are calculated on a different basis that if used to calculate those credits would have given a higher figure.
- 4. Amounts recognised for accounting purposes in respect of depreciation in the last period of account before the change, to the extent that they were not the subject of an adjustment for tax purposes, where such an adjustment would be required on the new basis.

Second step

Then deduct any amounts representing the extent to which, comparing the two bases, profits were overstated (or losses understated) on the old basis:

1. Receipts which were brought into account in a period of account before the change, to the extent that they would not have been so brought into account if the profits had been computed on the new basis.
2. Expenses which were not brought into account in computing the profits of a period of account before the change, to the extent that they—
 - (a) would have been brought into account for a period of account before the change if the profits had been computed on the new basis, and
 - (b) would have been brought into account for a period of account after the change if the profits had continued to be computed on the old basis.
3. Credits in respect of closing trading stock or closing work in progress in the last period of account before the change of basis, to the extent that they—
 - (a) are not matched by deductions in respect of opening trading stock or opening work in progress in the first period of account on the new basis, or
 - (b) are calculated on a different basis that if used to calculate those deductions would have given a lower figure.

An amount so deducted may not be deducted again in computing the profits of a period of account.

Meaning of items being brought into account

- 3 (1) The references in paragraph 2 to items being brought into account in a period of account before the change of basis are to their being brought into account—
 - (a) in computing the profits of the same trade, profession or vocation, and
 - (b) in accordance with the law or practice then applicable.
- (2) For the purposes of sub-paragraph (1)(a) a trade, profession or vocation is not regarded as the same if section 113(1) or 337(1) of the Taxes Act 1988 applies (deemed discontinuance on change of persons carrying on trade, profession or vocation).
- (3) For the purposes of sub-paragraph (1)(b) the practice applicable in any case means the accepted practice in cases of that description as to how profits should be computed for the purposes of Case I or II of Schedule D.

Giving effect to positive adjustment

- 4 (1) If the amount of the adjustment is positive, it is chargeable to tax.

Status: This is the original version (as it was originally enacted).

- (2) An amount so chargeable to income tax—
- (a) is treated as income arising on the last day of the first period of account for which the new basis is adopted;
 - (b) is chargeable under Case VI of Schedule D;
 - (c) in the case of an individual whose income from the trade, profession or vocation in question is—
 - (i) relevant earnings within section 623(2)(c) or 644(2)(c) of the Taxes Act 1988, or
 - (ii) earned income within section 833(4)(c) of that Act,is similarly relevant earnings or earned income for the tax year in which it is charged to tax; and
 - (d) is treated for the purposes of Chapters 1 and 2 of Part 10 of the Taxes Act 1988 (loss relief) as profits of the trade, profession or vocation for the chargeable period for which it is charged to tax.
- (3) An amount so chargeable to corporation tax is treated as a receipt of the trade, profession or vocation arising on the last day of the first period of account for which the new basis is adopted.

Giving effect to negative adjustment

- 5 (1) If the amount of the adjustment is negative, it is allowed as a deduction in computing profits.
- (2) An amount so allowed as a deduction in computing profits is treated as an expense of the trade, profession or vocation arising on the last day of the first period of account for which the new basis is adopted.

PART 3

SPECIAL RULES FOR CERTAIN CASES

No adjustment for certain expenses previously brought into account

- 6 (1) This paragraph applies where as a result of a change of basis expenses brought into account before the change on the old basis would on the new basis be brought into account over more than one period of account after the change.
- (2) In such a case—
- (a) no adjustment shall be made under this Schedule, and
 - (b) the expenses may not be deducted in computing the profits of the trade, profession or vocation for any period of account after the change.

Cases where adjustment not required until asset realised or written off

- 7 (1) This paragraph applies where there is a change of basis resulting from a tax adjustment affecting the calculation of—
- (a) any amount brought into account—
 - (i) in respect of closing trading stock or work in progress in the last period of account before the change of basis, or

Status: This is the original version (as it was originally enacted).

- (ii) in respect of opening trading stock or work in progress in the first period of account on the new basis, or
 - (b) any amount brought into account in respect of depreciation.
- (2) The adjustment required by paragraph 2 in such a case shall be brought into account only when the asset to which it relates is realised or written off.

Change from realisation basis to mark to market

- 8 (1) This paragraph applies where there is a change of basis from—
- (a) not recognising a profit or loss on an asset until the asset is realised, to
 - (b) bringing assets into account in each period of account at a fair value.
- (2) To the extent that in such a case—
- (a) a receipt within item 1 of the First step in paragraph 2 represents the fair value of an asset that is trading stock (within the meaning of section 100 of the Taxes Act 1988), or
 - (b) an expense within item 2 of that step relates to such an asset,
- any resulting adjustment shall not be given effect until the period of account in which the value of the asset in question is realised.

This is subject to any election under paragraph 9.

Election for spreading where paragraph 8 applies

- 9 (1) Where paragraph 8 applies the person who is chargeable to tax in respect of any adjustment charge may elect that the adjustment charge shall be spread over six periods of account in accordance with the following provisions.
- (2) The election must be made—
- (a) by notice in writing,
 - (b) to an officer of the Board,
 - (c) within the time allowed.
- (3) The time allowed is—
- (a) for income tax purposes, up to and including the 31st January following the tax year in which the change of basis occurs;
 - (b) for corporation tax purposes, within twelve months of the end of the first accounting period to which the new basis applies.
- (4) If an election is made, then, in each of the six periods of account beginning with the first period to which the new basis applies an amount equal to one-sixth of the amount of the adjustment charge is treated as arising and chargeable to tax.
- (5) If before the whole of the adjustment charge has been charged to tax the trade, profession or vocation is permanently discontinued, the whole of the amount so far as not previously brought into charge to tax is treated as arising and chargeable to tax immediately before the discontinuance.

Application of paragraphs 8 and 9 in case of transfer of insurance business

- 10 (1) This paragraph applies where—

Status: This is the original version (as it was originally enacted).

- (a) an asset to which paragraph 8 or 9 applies is transferred from one insurance company to another in pursuance of a transfer scheme, and
 - (b) immediately after the transfer either—
 - (i) the transferee company is resident in the United Kingdom, or
 - (ii) the asset is held for the purposes of a business carried on by the transferee company in the United Kingdom through a branch or agency.
- (2) The asset shall not be regarded for the purposes of paragraph 8 as having been realised by the transferor by reason of its being transferred in pursuance of the transfer scheme.
- (3) If the transfer is of the entire business of the transferor, the transferee is responsible under paragraph 8 or 9 for bringing into account any amount required to be brought into account after the transfer.
- (4) In this paragraph—
“insurance company” has the same meaning as in Chapter 2 of Part 12 of the Taxes Act 1988 (see section 431(2) of that Act); and
“transfer scheme” means—
 - (a) a scheme under section 105 of the Financial Services and Markets Act 2000 (c. 8), including an excluded scheme falling within Case 2, 3 or 4 of subsection (3) of that section, or
 - (b) a qualifying overseas transfer scheme.
- (5) A “qualifying overseas transfer scheme” means—
 - (a) so much of a transfer of the whole or part of the business of an overseas life insurance company carried on through a branch or agency in the United Kingdom as takes place in accordance with an authorisation granted outside the United Kingdom for the purposes of Article 11 of the third life insurance directive, or
 - (b) so much of a transfer of the whole or part of the business of an insurance company other than an overseas life insurance company as takes place in accordance with an authorisation granted outside the United Kingdom for the purposes of Article 12 of the third non-life insurance directive.
- (6) In sub-paragraph (5)—
“overseas life insurance company” has the same meaning as in Chapter 2 of Part 12 of the Taxes Act 1988 (see section 431(2) of that Act);
“the third life insurance directive” means Council Directive 92/96/EEC on the co-ordination of law regulations and administrative provisions relating to direct life assurance and amending Directive 79/267/EEC and 990/96/EEC; and
“the third non-life insurance directive” means Council Directive 92/ 49/EEC on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and amending Directives 73/239/EEC and 88/357/EEC.

Spreading of adjustment charge on ending of exemption for barristers and advocates

- 11 (1) This paragraph applies where an individual makes a change of basis—

Status: This is the original version (as it was originally enacted).

- (a) on ceasing to take advantage of the exemption given by section 43 of the Finance Act 1998 (c. 36) (barristers and advocates in early years of practice), or
 - (b) on that exemption coming to an end.
- (2) Where this paragraph applies any adjustment charge is spread over ten tax years, as follows.
- (3) In each of the nine tax years beginning with that in which the whole amount would otherwise be chargeable to tax, an amount equal to whichever is the less of—
- (a) one-tenth of the amount of the adjustment charge, and
 - (b) 10% of the profits of the profession for that tax year,
- is treated as arising and chargeable to tax.
- For the purposes of paragraph (b) the profits of the profession means the profits as computed for the purposes of Case II of Schedule D, leaving out of account any allowances or charges under the Capital Allowances Act 2001 (c. 2).
- (4) In the tenth tax year the balance of the adjustment charge is treated as arising and chargeable to tax.
- (5) If before the whole of the adjustment charge has been charged to tax the profession is permanently discontinued, the preceding provisions of this paragraph continue to apply, but with the omission of the alternative limit in sub-paragraph (3)(b) by reference to profits of the profession.
- (6) This paragraph has effect subject to any election under paragraph 12.

Election to accelerate payment of adjustment charge under paragraph 11

- 12 (1) A person who under paragraph 11 is chargeable to tax for a tax year on an amount representing part of an adjustment charge may elect that the amount treated as income arising in that tax year should be increased.
- (2) The election must be made—
- (a) by notice in writing,
 - (b) to an officer of the Board,
 - (c) on or before the 31st January following the tax year in question.
- (3) The election must specify the amount to be treated as income arising in the tax year, which may be any amount up to the whole of the adjustment charge so far as not previously charged to tax.
- (4) Where an election has been made, paragraph 11 applies in relation to any subsequent tax year as if the original amount of the adjustment charge were reduced by the additional amount treated as arising in the year for which the election was made.

PART 4

SUPPLEMENTARY PROVISIONS

Application of provisions to partnerships

- 13 (1) In the case of a trade, profession or vocation carried on in partnership, the amount of any adjustment under this Schedule shall be computed—
- (a) for income tax purposes, as if the partnership were an individual resident in the United Kingdom, and
 - (b) for corporation tax purposes, as if the partnership were a company resident in the United Kingdom.
- (2) Subject to the following provisions of this paragraph—
- (a) each partner's share of any amount chargeable to tax under this Schedule shall be determined according to the profit-sharing arrangements for the twelve months ending immediately before the date on which the new basis was adopted; and
 - (b) any election under this Schedule must be made jointly by all the persons who have been members of the partnership in that twelve month period.
- (3) If paragraph 11 applies (spreading of adjustment charge in certain cases), then, subject to sub-paragraph (4) below, each partner's share of the amount chargeable in any tax year shall be determined—
- (a) for the first tax year, according to the profit-sharing arrangements for the twelve months ending immediately before the date on which the new basis was adopted, and
 - (b) for any subsequent tax year, according to the profit-sharing arrangements for the twelve months immediately preceding the anniversary in that year of that date.
- (4) If paragraph 11(5) applies (effect of discontinuance of profession), then—
- (a) each partner's share of any amount chargeable on or after the discontinuance is determined as follows—
 - (i) if the discontinuance occurs on the date on which the new basis was adopted, according to the profit-sharing arrangements for the twelve months ending immediately before that date;
 - (ii) if the discontinuance occurs after that date but before the first anniversary of that date, according to the profit-sharing arrangements for the period between that date and the date of discontinuance;
 - (iii) if the discontinuance occurs after the first anniversary of the date on which the new basis was adopted, according to the profit-sharing arrangements for the period between the immediately preceding anniversary of that date and the date of discontinuance; and
 - (b) any election under paragraph 12 after the discontinuance must be made by each former partner separately.
- (5) For the purposes of this paragraph—
- (a) “profit-sharing arrangements” means the rights of the partners to share in the profits of the trade, profession or vocation for the period in question; and

Status: This is the original version (as it was originally enacted).

- (b) references to the date on which a new basis was adopted are to the first day of the first period of account for which the new basis was adopted.
- (6) The provisions of section 111 of the Taxes Act 1988 (general provisions as to taxation of partnerships), except subsection (1) (partnership not to be treated as separate entity), do not apply to the extent that the preceding provisions of this paragraph apply.

Liability of personal representatives in case of death of person chargeable

- 14 In the case of the death of a person who, if he had not died, would have been chargeable to tax under this Schedule on an amount representing part of an adjustment charge—
- (a) the tax which would have been so chargeable shall be assessed and charged on his personal representatives and shall be a debt due from and payable out of his estate, and
 - (b) his personal representatives may make any election under this Schedule that he might have made.

Interpretation

- 15 In this Schedule—
- “adjustment charge” means a charge under Part 2 of this Schedule; and
 - “tax year” means a year of assessment.

PART 5

COMMENCEMENT

General rule

- 16 The provisions of this Schedule apply to a change of basis taking effect in a period of account ending on or after 1st August 2001.

Application of provisions to certain earlier changes of basis

- 17 (1) So far as they relate to a change of basis within—
- (a) paragraph 6 (no adjustment for certain expenses previously brought into account), or
 - (b) paragraph 8 (change from realisation basis to mark to market),
- the provisions of this Schedule apply to a change of basis taking effect in a period of account ending before 1st August 2001 if a relevant return is delivered or voluntarily amended by the taxpayer on or after that date.
- (2) For the purposes of sub-paragraph (1) a “relevant return” means—
- (a) a return under section 8 or 8A of the Taxes Management Act 1970 (c. 9) (personal or trustee return),
 - (b) a partnership return, or
 - (c) a company tax return,

for the period in which the change of basis took effect or a subsequent period of account ending before 1st August 2001.

- (3) The reference in sub-paragraph (1) to the voluntary amendment of such a return is to—
- (a) an amendment under section 9ZA or 12ABA of the Taxes Management Act 1970 (amendment of personal, trustee or partnership return by taxpayer), or
 - (b) an amendment of a company tax return by the company otherwise than in response to a closure notice.
- (4) An adjustment that would be required by virtue of this paragraph to be given effect in a period of account ending before 1st August 2001 shall be given effect in the first period of account ending on or after that date.

Period in which change of basis takes effect

- 18 The references in paragraphs 16 and 17 to the period of account in which a change of basis takes effect are to the first period of account in which the new basis is adopted.